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November 3, 2003

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The Honorable James E. Gilleran
Director
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Docket No. R-1154

Dear Sirs:

The House Committee on Financial Services submits these comments to the federal banking regulators on the advanced notice of proposed rulemaking (ANPR) relating to the proposed revisions of the Basel Capital Accord (Basel II). We want to commend you for your important work to address the much needed changes to the current Basel Capital Accord (Basel I). In particular, the Committee believes that the recent decision to recognize only unexpected losses as they relate to credit risk is an important step toward improving the Basel II proposal. This change will appropriately redirect the focus of regulatory capital, and we expect that the next version of the proposed U.S. rules will reflect this revision.

We emphasize the importance of considering the full range of implications associated with the new framework raised by ourselves and other commenters. We are concerned that major competitive and market structure issues raised in the proposal have been subsumed within highly technical text that may not have been understood fully by all commenters. We seek to foster a thoughtful and thorough examination of all the issues so that this country can move forward with a new regulatory capital framework that is compatible with existing good risk management practices, establishes appropriate incentives for prudent risk taking among banks, and does not impair either innovation or the competitiveness of the U.S. financial system.

The United States is the largest, most efficient credit market in the world. It is our responsibility as representatives of the American people to ensure that any changes to our markets resulting from a new regulatory capital standard be well understood and discussed throughout the political and regulatory establishments so that we can move forward together with our financial partners internationally. Moving forward hastily to meet arbitrary deadlines without adequate consideration of the domestic, as well as international issues, risks creating misunderstandings, and unintended consequences.

The Financial Services Committee has jurisdiction over the U.S. financial markets, as well as the structure, functioning and regulation of domestic financial institutions and international implications of the regulation. The Committee has actively followed the development of Basel II and has held two subcommittee hearings on these revisions. The Committee learned from these hearings that the proposal is extremely complex and that disagreement exists among regulators, the affected financial institutions, and academia regarding the likely impact of the Basel II proposal. The Committee is very concerned that the federal regulators are making important public policy decisions outside of the political process. The federal regulators must recognize that Congress plays a role in any regulatory process that could have a sweeping effect on the domestic and international banking system. It is our concern that the regulators are moving too quickly and without consideration of the impact of this agreement. When we met with drafters of Basel II we were routinely assured that the Accord will be improved to address our concerns, however, throughout the process we have seen few changes that satisfy us.

During the hearings, Members of the Committee expressed concern that the federal banking regulators were negotiating on behalf of the United States without express authority to bind the U.S. and its financial institutions to the agreement. Additionally, the Committee learned of concerns many banks in the United States have regarding the proposed regulatory capital treatment of operational risk and credit risk, as well as the impact the Basel II proposal would have on competition, the commercial real estate market, securitizations, and the international treatment of accounting.

If the changes to Basel I as whole, or individual parts, are designed to prevent banks from lending to specific higher risk borrowers, the framework effectively seeks to allocate credit only to the most credit-worthy borrowers. The message this conveys is that commercial banks should provide lending facilities only to the safest borrowers. It also suggests that time-honored secured lending practices which evolved over the years precisely to protect banks and enable them to lend to risky borrowers (and help fuel economic growth) may be disadvantaged relative to more liquid, more easily traded, and less secured forms of lending.

It is clear that at least certain parts of the banking industry are moving in this direction. However, if the regulatory capital framework seeks to accelerate this trend, it should do so clearly and a public policy debate should be invited on the wisdom of such a bias in the regulatory capital framework for the banking system as a whole. If no such sweeping changes are anticipated, then the Basel Committee and the U.S. federal banking regulators should seek to ensure that traditional lending activities are not disadvantaged throughout the framework.

Within the United States, the regulatory capital framework should strike a balance between ensuring that the U.S. financial system and the firms within it remain globally competitive without undermining the role of more traditional, domestically-focused firms. We have doubts that this balance has been struck within the current proposals.

This letter reflects the primary areas of concern that the Members of the Financial Services Committee have with the Basel II proposal. We look forward to your response to these comments.

The Basel Committee Negotiations

The Committee discovered in its February 27, 2003 hearing that not all of the federal financial regulators were in agreement on how the current Basel Accord should be structured or what impact the current proposal will have on domestic financial institutions. In a second hearing held on June 19, 2003, the Committee received testimony from academics, financial institutions, and the federal financial regulators. At this hearing, greater agreement seemed to exist among the regulators, but not unanimity. The Members of the Committee believe that this discord weakened the U.S. negotiating position at the Bank for International Settlements (BIS) and resulted in an agreement that was less favorable to U.S. financial institutions.

H.R. 2043, the "United States Financial Policy Committee For Fair Capital Standards Act," was introduced by Financial Institutions and Consumer Credit Subcommittee Chairman Bachus, with Domestic and International Monetary Policy, Trade and Technology Subcommittee Ranking Member Maloney, to address these concerns and provide oversight for the Basel negotiations. This legislation establishes a committee among the financial regulators to ensure that there is a unified U.S. position in the negotiations at the BIS. The proposed committee would be chaired by the Secretary of the Treasury and would report its positions to Congress on a regular basis. H.R. 2043 was considered by the Subcommittee on Financial Institutions and Consumer Credit and approved unanimously by a vote of 42-0. The Full Committee has yet to consider this legislation.

It is critical that the Basel Committee strike the right balance between regulation that provides the necessary supervision for domestic and international banks while ensuring that these regulations do not stifle growth and innovation. Members of the Financial Services Committee agree that the current regulatory capital framework must be updated to reflect modern risk management practices and to eliminate regulatory arbitrage opportunities that the existing rules create. We are not convinced, however, that the current proposals would accomplish these goals. The proposals do not support modern risk management practices uniformly since they embrace banks' internal risk models in some areas while they would impose prescriptive, detailed regulatory calculation systems in others.

We are concerned that the bank capital charges created by Basel II, if implemented, could be overly onerous and may discourage banks from engaging in activities which promote economic development. Crafting a framework that would create a two-tier banking system (diversified banks and non-diversified or specialized banks) through technical

regulatory capital proposals without a full and public debate on the domestic implications is inappropriate.

We are concerned that in the process of negotiating a regulatory capital framework for globally active banks with diversified balance sheets, regulators may have not devoted sufficient attention to the likely impact that the new framework would have on the domestic financial system generally and on mono-line banks in particular. While the ANPR process initiated that dialogue within the United States, we are concerned that the process was begun too late to have a material impact on the structure and content of the international regulatory capital framework.

The Committee has been pleased to learn that the Basel Committee intends to initiate a fourth qualitative impact study (QIS 4). We are also pleased to learn that the U.S. banking regulators are studying the possible competitive impact of the proposal on the domestic banking system. Further, we understand that four major U.S. securities firms are similarly studying the possible impact of the new capital framework on their businesses. We strongly encourage delay in completion of the Basel II details until the results of these studies are collected and analyzed thoroughly. We also recommend that if the U.S. banking system could be adversely affected (either domestically or internationally), appropriate changes in the framework and its scope of application within the United States should be made.

Operational Risk

The Committee remains concerned that Pillar I treatment of operational risk could have unintended adverse consequences for many financial institutions, both domestically and internationally. Many institutions, particularly custodial banks, may be forced to change their business models in order to remain competitive if the Basel II proposal was implemented in its current form.

Basel II attempts to reduce regulatory arbitrage opportunities under the current framework. Regulators rightly seek to prevent firms from shifting assets within the balance sheet through instruments not specifically covered by Basel I. However, the Pillar I treatment of operational risk is not necessary in order to prevent this activity. In certain circumstances, Pillar I treatment could actually create new regulatory arbitrage opportunities if incentives exist for institutions to characterize certain losses (e.g., fraud) as operational rather than credit risk in order to obtain a more lenient regulatory capital treatment.

It is far from clear that requiring banks to track such losses as being both credit and operational in nature, but charging regulatory capital only against the credit risk loss is a good long run solution. This compromise suggests instead that industry best practices have not yet evolved sufficiently to articulate a clear regulatory capital standard. As noted above, this also suggests that regulators themselves have not clearly determined whether banks should be considered primarily as processing institutions (such that regulatory capital would be held principally to cover operational risks, which would include risks previously characterized as being credit in nature) or as credit intermediaries.

We believe that the proposed Pillar I treatment of operational risk is also misleading since it will not create an objective standard. The Advanced Measurement Approach (AMA) proposed within the Pillar I treatment would create significant scope for supervisory judgment and discretion. In addition, if Host supervisors must use Pillar 2 to top-up local regulatory capital in the event that the allocation from the Home country is perceived as being insufficient, then much of the certainty ostensibly created by Pillar 1 treatment is eliminated (Home/Host regulatory issues are discussed below). The Committee suggests that if the federal regulators and the financial industry have not yet settled on a best practice standard for measuring and assessing internal economic capital for operational risk, then the imposition of a Pillar I charge for this risk should be delayed until such an industry standard is developed. In the interim, regulators should not require a large number of financial firms to change their proven internal risk management practices.

When considering operational risk, a bank examiner must look at the nature of the risk, the quality of the controls that the bank has to address the potential risk, and the quantification of that risk. The regulator then must translate that risk assessment into a capital charge. This is a highly subjective exercise, given the amount of discretion available under the proposed AMA for operational risk. Pillar II, or supervisory treatment, of operational risk would be consistent with the amount of discretion currently contemplated for the AMA within the proposal and, we believe, would be sufficient for U.S. institutions to address concerns regarding possible deficiencies in operational risk management that would arise during a bank exam. Pillar Two treatment would empower examiners to establish, on a case-by-case basis, the level of capital an institution would need to address these concerns. We do not believe that Pillar Two treatment would compromise comparability across borders upon implementation because so much discretion already exists within the current Pillar One proposal that we question whether it could be implemented in a comparable manner internationally.

The proposed Pillar I operational risk charge could also put U.S. banks at an undue competitive disadvantage at home and abroad. U.S. regulators cannot impose this charge on non-banks, which are major competitors in such areas as asset management, custodial services and payment processing. Internal economic capital requirements are markedly different from the proposed regulatory ones, which means that these large non-bank firms will operate at a significant advantage over banks in these key lines of business. We understand that some banks may abandon their charter and become non-banks, while others could be forced to sell these operations resulting in less effective customer service.

Finally, the Federal Reserve and the other financial regulators have been encouraging financial institutions to adopt critical infrastructure improvements to their systems. At the same time these institutions will be assessed an automatic regulatory capital charge for operational risk under Pillar 1. U.S. banks therefore would be charged twice for similar protection. In order to ensure that our financial system is protected, individual institutions must be encouraged to develop individual solutions to their risk needs. Imposing regulator-defined standard solutions for the broad range of intermediation activities and supporting operational processes is premature. Our concern is that a Pillar I capital charge could result in restrictions in risk mitigation efforts. We urge the U.S. federal regulators to rely on Pillar II for operational risk regulatory capital, while encouraging banks to enhance both their critical infrastructure protection systems and their operational risk management systems.

Commercial Real Estate

We believe that the Basel Committee has greatly improved the original Basel II proposal regarding the treatment of commercial real estate. We specifically note that the application of the wholesale risk weight function for corporate loans is a significant improvement. However, in order to ensure that banks are not forced out of the commercial real estate lending business as a result of an arbitrary capital charge, some additional changes are needed. Loans that have been designated as "high volatility commercial real estate" under the Basel II proposal will be subject to a modified wholesale risk weight function that will increase risk weights as much as 25% above what is charged for low asset correlation commercial real estate loans.

The ANPR designates acquisition, development and construction loans as high volatility commercial real estate loans, but exempts these loans from high volatility treatment if the borrower has substantial equity, or if the source of repayment is substantially certain. While these are important factors in assessing risk, sound lending policies often take into consideration additional elements when assessing the quality of a loan. Any attempt to draw a bright line between low asset correlation commercial real estate loans and highly volatile commercial real estate loans that do not have substantial equity or a repayment source would be highly speculative and could lead to a significant reduction in the amount of lending undertaken.

The Committee is concerned that the increased risk weight for these loans does not take into consideration the success experienced by many U.S. institutions engaged in acquisition, development and construction lending. These types of loans provide much needed liquidity to the marketplace and foster economic growth. While the Committee agrees it is important to have a regulatory capital standard that avoids the kinds of real estate crises we have seen in the past, Members question whether the level of conservatism in the proposed treatment for these assets is appropriate.

The Committee recognizes that in the past losses related to construction loans presented a substantial risk, particularly overseas. The commercial real estate market has been implicated in a number of banking crises during the 1970s and 1980s in the U.S., Japan, and Europe. Since then, however, improved risk management standards and a tightening of lending principles have significantly reduced the risks that this type of lending can pose for the financial system. The Committee is concerned that the excessive conservatism regarding this asset class in the Basel II proposal fails to recognize improvements in risk management practices within the banking sector during the last decade. As a result, we are concerned that implementation of the proposals could stifle construction financing, which has been a major driver of economic growth in the U.S. We urge that the Basel II proposal be modified to provide unified treatment for all commercial real estate exposures including acquisition, development and construction loans.

Competitive Environment - Among Banks

U.S. financial regulators have announced their intention to apply the Basel II proposal only to the largest internationally active institutions. The presumption seems to be that only those firms will have the resources and interest in updating their internal risk

management systems in a manner compatible with the new framework. Other institutions would comply with Basel II on a voluntary basis.

The Committee is concerned that many banks on the cusp of qualifying for Basel II would be competitively disadvantaged by this proposal. These institutions will be forced to decide whether to make significant capital expenditures in order to develop the necessary systems and models to comply with the complex Basel II requirements. This is particularly true for operational risk, where best market practice has not yet emerged.

It is unclear how non-compliance with Basel II would affect small to mid-sized financial institutions. It is likely that the market and, in particular, rating agencies, will look more favorably upon Basel II-compliant firms, resulting in these institutions gaining a competitive advantage against those that cannot comply. This could result in smaller institutions losing market share based, not on their lending practices, but solely on the effect of these regulations. Additionally this may generate increased concentration in the banking industry as institutions that are less competitive are bought by larger, Basel II-compliant banks.

The Committee is concerned that excessive consolidation as a result of Basel II could reduce competition and access to financial institutions, as well as have a negative impact on customer service. The potential for artificial market manipulation through regulation is highly problematic. The new framework will reward banks with particular business lines (e.g., revolving credit and/or secured corporate lending) while penalizing banks with other business lines. The Committee is aware that increasingly the U.S. banking market is bifurcated between globally active and domestically-focused banks. However, it is unclear how the existing market structure will be affected by a regulatory capital framework that seeks to penalize certain traditional forms of banking (e.g., commercial real estate lending; payments processing; unsecured corporate lending) while favoring other banking services (e.g., credit card lending; mortgage lending; secured corporate lending).

Competitive Environment – Between Banks and Securities Firms

Basel II will likely apply to U.S. securities firms with operations in Europe through the European Union's Capital Adequacy Directive. In addition, the Securities and Exchange Commission (SEC) recently issued proposed regulations to create an Investment Bank Holding Company Framework (IBHC) pursuant to its authority under the Gramm-Leach Bliley Act (GLBA). That proposal would require IBCHs to calculate internal economic capital in a manner consistent with the mechanisms contained in the Basel II framework. Because GLBA did not authorize the SEC to assess regulatory capital against IBHCs, the SEC cannot require such companies to hold regulatory capital in the amount generated by this calculation. In the United States, broker-dealers within the IBHC structure would remain subject to the SEC's net capital rule, which generally assesses increased regulatory capital charges against individual positions as liquidity in those positions decreases.

While regulatory capital charges impact all capital market participants, Basel II may disproportionately affect securities firms and investment banks. These firms mark-to-market their positions and immediately recognize changes in their risk profiles. The risk allocation mechanisms for credit and operational risks in this context may be substantially

different than the one associated with accruals-based management measures upon which the Basel II framework is based. The Committee further understands that the recently announced Basel Committee decision to calibrate the regulatory capital framework only to unexpected losses could alleviate some of the more egregious adverse effects on the firms that primarily market their traded credit portfolios to market.

In addition, we understand that the Basel II framework as currently drafted does not adequately address the difference between the trading and banking books of a financial firm. The Basel II framework also would impose significant new regulatory capital charges on firms with a high proportion of processing activity, such as retail brokerage firms. As a consequence, Basel II regulatory capital requirements could misallocate capital and could artificially impair liquidity for securities and investment firms by requiring them to hold capital as if their assets were illiquid or unsecured.

Given these issues (availability of a new regulatory structure in the U.S.; marking to market; the operational risk charge), it is difficult to determine clearly which type of institution (e.g., banks, securities firms, processing banks) would be more disadvantaged than another. It is clear, however, that these kinds of significant changes in the regulatory capital structure for one kind of financial institution (banks) will have a competitive impact through the financial markets. It is not evident from the information available from either the Basel Committee or the U.S. federal banking regulators whether the competition between commercial depository institutions and investment banks has been considered.

We believe that a more thorough vetting of the possible competitive consequences is warranted in the United States, especially in light of the recent SEC proposals to create IBHCs with capital standards paralleling the Basel II standards. We encourage the federal banking regulators to delay any further decisions regarding Basel II until the data from ongoing impact studies have been evaluated fully.

Cost and Complexity

At this time it is difficult to quantify what the costs of the Basel II will be on financial intuitions in the U.S. Some institutions estimate that implementation will cost approximately \$70 million to \$100 million to startup, even though they already use fairly sophisticated techniques for measuring economic capital on an internal basis. When these costs are multiplied by the thousands of banks within the global banking system, this may amount to billions of dollars in additional costs.

However, it is difficult to determine which costs could be attributed solely to the regulatory capital framework and which costs would be incurred by banks seeking to upgrade their internal risk management systems. It is clear that some costs will be associated exclusively with regulatory compliance since the new regulatory capital framework would merely align (rather than converge) with firms' internal economic capital calculation processes. Some of these costs will be passed on to consumers and corporations, which would generate inefficiencies in the banking market.

The proposal is highly complex. As Comptroller Hawke stated in the February 6, 2003 hearing, "It is infinitely more complex than it needs to be. It is not complex simply because we are dealing with a complex subject. It is not only complex, it is virtually

impenetrable." The Committee agrees that the regulatory capital framework needs updating and also recognizes that financial markets and intermediation activities have become more complex. However, we believe that the proposal is excessively complex and will create burdens for financial regulators around the world who will be charged with administering this Accord. While the resource challenges in this country will be significant, we worry that other countries with fewer resources will not have the capacity to implement the new framework, thus creating potential supervisory gaps and risks for the global financial system.

We believe it would be more advisable to adopt a simpler rule that supervisors can enforce equitably and effectively. This would eliminate potential competitive distortions, ensure that all banks will be able to understand their compliance requirements, and would facilitate in a meaningful implementation internationally. We encourage the federal banking regulators to seek wherever possible to streamline and simplify the new framework.

Securitization

The Committee welcomes the recent announcement that the regulatory capital treatment of securitization instruments will be simplified to reflect better existing risk management practices and data. Nonetheless, Committee Members are concerned that proposed treatment of securitized assets is overly harsh. Securitization vehicles, when used prudently, provide a useful mechanism for distributing otherwise illiquid credit risks throughout the capital markets.

The proposal to use regulatory parameters to require external ratings for all tranches of a securitization vehicle is problematic because some tranches will be rated internally. Failure to recognize internal ratings for these tranches suggests that banking supervisors trust unregulated rating agency processes and judgments more than the information and risk management tools available to the banks themselves, over which the regulators have direct oversight. This is inappropriate and is inconsistent with other parts of the proposed regulatory capital framework which would recognize banks' internal ratings subject to some standard regulatory assumptions.

We suggest that setting regulatory capital charges in relation to third party ratings for all securitization tranches is inappropriate since firms have sufficient data to assess the risks for a broad range of senior tranches, not covered by ratings agencies. We understand that data supporting internal ratings for all securitization tranches has been submitted to the Basel Committee and we urge serious reconsideration of the proposed approach in light of these comments and data.

The Basel proposal also calls for excessive capital when assessing regulatory capital for securitizations. This will lower incentives for banks to engage in activities that decrease their risk exposures and disseminate the risk of a particular transaction throughout the capital markets.

For example, the floor for the regulatory capital charge is too high for many securitization positions in light of their actual risk profile. Sub-investment grade positions in particular attract excessive capital under the proposal, given the actual credit risk they

present. Implementation of the proposal could result in decreased access to credit for lower quality borrowers since banks would not be able to securitize these assets in an economically efficient manner. In addition, setting the regulatory capital floor in relation to individual transactions creates a cumulative regulatory capital charge that not only is excessive but could also be counterproductive. We understand that calculating the appropriate amount of regulatory capital for certain tranches of a securitization vehicle may be difficult since these tranches may be on the outside of the tail of the distribution. Nonetheless, it is neither fair nor appropriate to penalize other tranches of the vehicle which may have different risk characteristics and could affect credit access. We also do not understand why the Basel Committee may be willing to assess regulatory capital at the portfolio level for certain asset classes (e.g., revolving retail lending) but not others (e.g., securitization).

Finally, the Committee believes that Basel II, as proposed, fails to recognize modern risk-management techniques regarding a wide range of accepted and important secured transactions (e.g., securities lending, repurchase transactions). By failing to recognize existing and accepted risk management activities through these instruments, the proposed regulatory capital charges would not reflect true balance sheet risk, resulting in decreased efficiency and increased cost for banks and their customers.

Future International Supervisory Interaction

In addition to the Basel negotiations, the Financial Services Committee is concerned with the nature and structure of implementation and enforcement of the new regulatory capital standard, whatever form it takes. Commonly referred to as the "Home/Host" issue, we are concerned because globally active banks increasingly need banking regulators to collaborate in new ways that may not have been contemplated by their authorizing statutes.

As the Home and Host to many leading international financial institutions, the United States plays a critical role in helping to create free, open, and competitive capital markets. We are keenly aware that the responsibilities of both the Home and Host regulator in the United States need to be balanced carefully so that the global competitiveness and the safety and soundness of the U.s. financial system is not compromised. We are also aware that the interlocking nature of global capital markets both enhances the ability of capital to find productive uses around the world and simultaneously increases the risk that weakness in one banking market can be transmitted internationally to another one.

We are concerned, therefore, to see suggestions that regulatory capital for operational risk may be determined only at the consolidated Home country level and then allocated down using an arbitrary and possibly crude mechanism that is not risk sensitive. This is especially problematic because it could undermine the credibility of establishing a risk-based capital framework. It is not convincing to suggest that Host regulators would have discretion to increase regulatory capital under Pillar II, since this would increase the perceived arbitrariness of the regulatory capital framework.

These concerns are compounded by the suggestion that this arbitrary mechanism would apply only in the operational risk area. Concern exists that such a system would

increase banks' incentives to characterize risks and losses as operational risks instead of credit risks in order to benefit from a more lenient treatment. If the goal of the Basel Committee is to suggest that banks, as intermediators of information, are more appropriately to be considered processing stations rather than absorbers of risk, then it should be clear about its intent and a full public discussion should address this issue. If this is not the regulators' intent, then a more transparent and thoughtful approach is needed to resolve the conundrum associated with national regulation of global firms. We are also unclear and, thus, concerned with respect to how the new framework would be implemented and how regulatory capital will be assessed for a financial institution with multiple regulators.

We are aware that U.S. federal banking regulators continue to work with the Basel Committee on how to address this problem, particularly through the Basel Committee's Accord Implementation Group. In addition, we note that the SEC's proposal to create IBCHs complicates any regulatory coordination process, especially if the protocols for this process have been set among banking regulators only without including the SEC in their deliberations. We therefore encourage the federal banking regulators to be forthcoming about their views on how these issues can be addressed as quickly as possible.

Accounting Issues

The Committee notes with interest that a growing number of banks are advocating that the Basel Committee and the International Accounting Standards Board (IASB) work together so that the regulatory capital framework and the international accounting standards are not incompatible. We note that the internal ratings-based approach, under certain circumstances, may favor banks that fair value their banking book assets. Also, the accounting treatment of provisions may complicate implementation of the new framework, especially for those banks that mark assets to market and reflect changes in value through the profit-and-loss account rather than through the balance sheet.

Changing the regulatory capital framework to reflect market trends without having a full public discussion about the implications those changes hold for accounting and intermediation activities is inappropriate. Attempting to address the changes in a piecemeal fashion to meet an arbitrary deadline risks developing standards that are not well-crafted, not well-understood, and that could generate financial market volatility. We encourage federal banking regulators to be more forthcoming about their assessment of the interaction between the regulatory capital and accounting framework and their views on whether additional coordination between the two disciplines is needed in order to implement the new capital framework.

Conclusion

We applaud the U.S. federal regulators for all the hard work that has gone into the proposed Basel II Accord over the years. It is a substantial improvement over the current framework. However, the changes outlined above should be addressed in any additional modifications to the Basel II proposal following the commentary period.

The Members of the Committee understand that many of the concerns articulated in this letter are not unique to the United States and that our colleagues in Europe hold

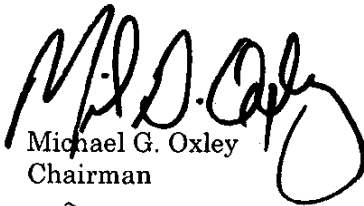
similar reservations, especially relating to the Basel II process and proposal. We strongly urge the Basel Committee to address fully the concerns raised by the political bodies in all of the affected countries.

The Committee views Basel II in a similar light as a trade agreement or treaties with foreign nations, which define the relationships between the U.S and foreign countries. Similarly, Basel II will define how U.S. and foreign financial institutions are supervised on a global level. Trade agreements and treaties are subject to Congressional review and approval as laid out in the Constitution. Consequently, we believe that Basel II should be reviewed by Congress prior to any final agreement that would affect U.S. and U.S.-based financial institutions in such a significant manner. Since it is expected that Basel II will be binding despite its informal status, we would like your views as to whether it could be viewed as establishing customary international law. If so, this could have significant implications regarding the rights and responsibilities of U.S. federal banking regulators when finalizing the new capital framework.

The Committee wants to ensure that no U.S. financial institutions are disadvantaged in the international marketplace and that the U.S. financial system remains internationally competitive and attractive. At the same time, we seek to ensure that no unintended consequences arise during implementation which could adversely affect our institutions, both large and small. Further, we want to ensure that an adequate public policy debate has occurred, both through the ANPR process and within the broader political process, to guarantee that all institutions understand and are prepared for the new framework.

Inaction on the items outlined above could force the Committee to take additional steps to ensure that the Congressional concerns are addressed. We appreciate your consideration of our comments to the ANPR consistent with all applicable law and regulation, and we look forward to your reply.

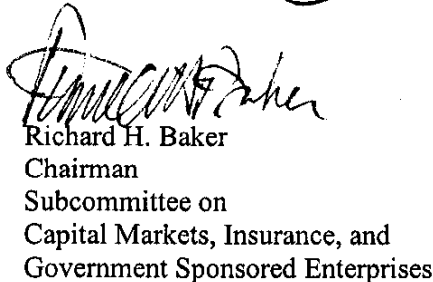
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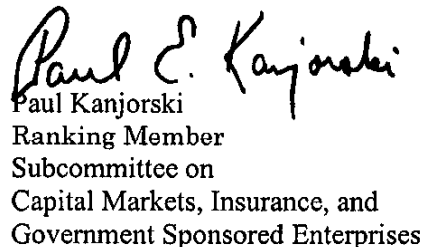
Michael G. Oxley
Chairman



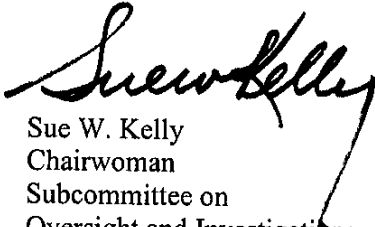
Barney Frank
Ranking Member



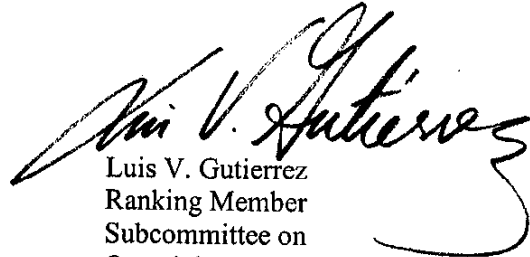
Richard H. Baker
Chairman
Subcommittee on
Capital Markets, Insurance, and
Government Sponsored Enterprises




Paul Kanjorski
Ranking Member
Subcommittee on
Capital Markets, Insurance, and
Government Sponsored Enterprises



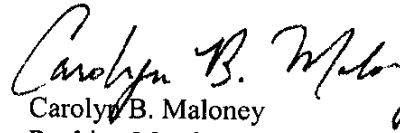
Sue W. Kelly
Chairwoman
Subcommittee on
Oversight and Investigations



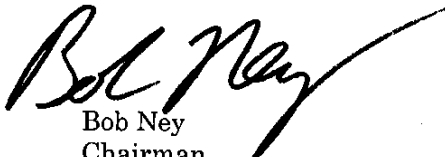
Luis V. Gutierrez
Ranking Member
Subcommittee on
Oversight and Investigations




Peter T. King
Chairman
Subcommittee on Domestic and
International Monetary Policy,
Trade, and Technology




Carolyn B. Maloney
Ranking Member
Subcommittee on Domestic and
International Monetary Policy,
Trade, and Technology



Bob Ney
Chairman
Subcommittee on Housing
and Community Opportunity



Maxine Waters
Ranking Member
Subcommittee on Housing
and Community Opportunity



Spencer Bachus
Chairman
Subcommittee on
Financial Institutions
and Consumer Credit